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# United States Senate

COMMITTEE ON BANKING, HOUSING, AND  
URBAN AFFAIRS

WASHINGTON, DC 20510-6075

May 26, 2004

Honorable Alan Greenspan  
Chairman, Federal Reserve Board of Governors  
20<sup>th</sup> Street and Constitution Avenue, NW  
Washington, DC 20551

CLO: #G - 67  
CCS: 04-5534  
RECVD: 5/26/04  
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## Re: Bounce Protection Services

Dear Chairman Greenspan:

I am writing to request that the Federal Reserve Board clarify that "bounce protection" services are covered by the Truth in Lending Act (TILA), 15 U.S.C. § 1601 *et. seq.* Continued inaction by the Board on this issue, or a decision to place bounce protection under the Truth in Savings Act, flaunts Congressional intent and hurts consumers.

In enacting **TILA**, Congress intended to promote meaningful disclosures about the cost of credit. TILA requires creditors to disclose the cost of credit as a dollar amount (the finance charge) and as an annual percentage rate (**APR**). Uniformity in disclosure is intended to help consumers compare costs and to promote competition among financial institutions. Bounce protection is the banking industry's foray into the extension of high-cost short-term credit. Bounce protection, with triple and quadruple digit APRs, is similar to payday lending--except with fewer disclosures to consumers. In March 2000, the Board, over the objections of the payday lending industry, issued a staff commentary clarifying that payday loans are subject to TILA and that payday lenders must disclose an APR for their loans. Bounce protection services should be required to provide the same level of disclosure.

Lenders that offer bounce protection abuse a provision of Regulation Z that applies TILA to transactions only where there is a prior written agreement by the bank to pay the overdraft. The financial institutions argue that, since they reserve the right not to pay an overdraft, TILA does not apply. These statements are often contradicted by advertising that flatly tells consumers that the financial institution will cover their bounced checks. In fact, most programs establish parameters for paying overdrafts without discretion (e.g. accounts must be open for 30 days and receive periodic direct deposit) and set limits for consumers (thus functioning as lines of credit).

If bounce protection services actually are discretionary, the consequences for consumers and the financial institutions that offer the service are troubling. Financial institutions are encouraging consumers to intentionally write checks for amounts larger than their account balance. If the financial institution chooses to exercise its discretion and not pay the draft (despite the assurances given in the promotional literature), the consumer may owe fees to the payee and "insufficient funds" fees. They may have also violated criminal and civil laws by knowingly writing a bad check. The Indiana Department of Financial Institutions and the Michigan Office of Financial and Insurance Services have noted that financial institutions that operate bounce protection programs that could lead to these results may be violating state laws. Likewise, if financial institutions really are not underwriting and monitoring these extensions of credit, they are likely engaging in unsafe and unsound banking practices.

Thank you for your attention to this matter.

Sincerely,

A handwritten signature in black ink, appearing to read "Paul Sarbanes", with a long horizontal flourish extending to the right.

Paul S. Sarbanes